Report

of the

Examination of

Watertown Mutual Insurance Company

Watertown, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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June 23, 2003

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2002, of the affairs and financial condition of

WATERTOWN MUTUAL INSURANCE COMPANY
Watertown, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1998 as of December 31, 1997. The current examination covered the intervening time period ending December 31, 2002, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on November 13, 1872, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Town of Watertown Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were two amendments to the articles of incorporation and one amendment to the bylaws. The company amended its articles of incorporation in February 1998 and again in February 1999 to increase its writing territory.

The company's bylaws were amended in September 1999 to state that "no Director of the Company may also serve as agent of the Company."

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

> Columbia, Dane, Dodge, Fond du Lac, Green, Iowa, Jefferson, Lafayette, Milwaukee, Ozaukee, Rock, Sauk, Sheboygan, Walworth, Washington, and Waukesha

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of one year with premiums payable on the advance premium basis. Policy fees charged policyholders are retained by the company.

Business of the company is acquired through 42 agents, none of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
Artisans	15 %
Business-Owners	15
Commercial-Mono Line	15
Condo-Owners	15
Dwelling Protector	12
Farm Protector	12
Farmowners	12
Homeowners	15
Preferred Homeowners	15
Preferred Mobile Homeowners	15
Mobile Home Protector	12
Mobile Homeowners	12
Mini-Farmowners	12
Specialty Risks	10

Agents do not have authority to adjust losses. Small property losses may be adjusted by the manager up to $25,000. Losses in excess and generally losses below this amount are adjusted by an independent adjusting firm approved by the company. The claims committee established, with board approval, these limits based on the difficulty in calling a committee meeting for each high claim. Also, the entire board reviews all claims, open and closed, at each board meeting. The manager receives $12.00 per hour for adjusting losses plus $0.365 per mile for travel allowance.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of seven members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Charles P. Crave	Farmer	Waterloo, WI	2005
Donald Bohn	Retired Farmer	Watertown, WI	2005
Dale Wolf	Social Services	Whitewater, WI	2005
Robert Salov	Computer Supplies Salesman	Cambridge, WI	2006
Thomas Vinz	Securities	Lake Mills, WI	2006
Kent Karberg	Retired School Teacher	Cambridge, WI	2004
Stephen Zillmer	Co-op Manager	Watertown, WI	2004

Members of the board currently receive $100.00 for each meeting attended and $0.36 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	2002 Salary
Charles P. Crave	President	$400
Stephen Zillmer	Vice-President	$200
Donald Bohn	Secretary/Treasurer	$200
Steven R. Nelson	General Manager	$45,500

Committees of the Board

The company's bylaws allow for the formation of certain committees of the board of directors. The committees at the time of the examination are listed below:

Claims Committee
Charles Crave, Chair
Kent Karberg
Dale Wolf
Steven Nelson

Executive Committee
Charles Crave, Chair
Stephen Zillmer
Donald Bohn
Steven Nelson

Investment Committee
Steven Nelson, Chair
Robert Salov
Tom Vinz
Charles Crave

Agents Advisory Committee
Steven Nelson, Chair
Charles Crave
Dave Wendt
Paul Kinas

Nominating Committee
Dale Wolf, Chair
Don Bohn
Connie Hoffman

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
1998	$467,919	$417,801	2,012	$(108,071)	$1,140,342	$716,497
1999	563,582	251,904	1,934	126,504	1,193,230	799,245
2000	471,826	360,829	1,958	13,008	1,433,245	907,925
2001	492,176	547,822	2,153	(218,975)	1,199,517	676,139
2002	650,800	259,629	2,047	151,718	1,395,353	744,623

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Net
1998	$903,695	$381,696	$716,497	126%	53%
1999	869,556	557,341	799,245	109	70
2000	893,540	486,991	907,925	98	54
2001	918,052	538,676	676,139	136	80
2002	993,813	735,700	744,623	133	99

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
1998	$417,801	$198,172	$467,919	89%	42%	141%
1999	251,904	213,084	563,582	45	38	83
2000	360,829	151,387	471,826	76	32	108
2001	547,822	217,234	492,176	111	44	152
2002	256,629	284,144	650,800	39	44	79

During the period under examination, policies in-force has remained stable, gross premiums written increased 10% and surplus increased during years with minimal losses and decreased in years of high losses. The recovery of surplus in 2002, after several large storms in 2001, was due to increased rates, continuous monitoring of agents'/agencies' loss ratios, and stronger underwriting guidelines. The loss and composite ratios increased during 1998 and 2001 due to significant windstorms, which resulted in net losses during these years. Overall, the company has made significant improvement in underwriting and operational results during the period under examination.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2003, continuous
Termination provisions:	By either company as of any January 1 by giving at least 90 days' advanced written notice

The coverage's provided under this treaty are summarized as follows:

1.	Type of contract:	Class A Liability
	Lines reinsured:	Liability
	Company's retention:	$1,250
	Coverage:	100% of each and every loss in excess of the company's retention, including LAE, subject to the maximum policy limits of: a. $1,000,000 per occurrence, single limited, combined for bodily injury and property damage liability b. $1,000,000 split limits, in any combination of bodily injury and property damage liability c. $5,000 for medical payments, per person; $25,000 per accident
	Reinsurance premium:	60% of premium written
2.	Type of contract:	Class B First Surplus
	Lines reinsured:	All property business
	Company's retention:	When the company's retention is $400,000 or more, the company may cede on a pro rata basis up to $800,000. When the net retention is less than $400,000, the company may cede on a pro rata basis up to 50% of such risk. The company retains an additional 10% of losses, which would otherwise be ceded under the contract.
	Coverage:	Pro rata share of each and every loss including LAE corresponding to the amount of risk ceded
	Reinsurance premium:	Pro rata portion of premiums corresponding to amount of each risk ceded

	Ceding commission:	15% of premiums paid
	Return commission:	100% of unearned premiums held by reinsurer at January 1, 2003, on all cessions up to $800,000 per risk
	Additional commission:	15% provisional commission with minimum 15% and maximum of 35% based on loss ratio
3.	Type of contract:	Class C-1 First Layer Excess of Loss
	Lines reinsured:	All property business
	Company's retention:	$30,000 In addition, the company shall retain, as an annual aggregate deductible, $30,000 of loss which would otherwise be recoverable
	Coverage:	100% of each and every loss, including LAE, in excess of the retention up to $70,000
	Reinsurance premium:	5.5% of net written premium as of 1/1/2003 with a minimum rate of 5.5% and maximum rate of 25%
4.	Type of contract:	Class C-2 Second Layer of Excess of Loss
	Lines reinsured:	All property business
	Company's retention:	$100,000
	Coverage:	100% of any loss, including LAE, in excess of the retention up to $300,000
	Reinsurance premium:	4% of the net premiums written, subject to a minimum of $29,000
5.	Type of contract:	Class D/E Stop Loss
	Lines reinsured:	All business written
	Company's retention:	Aggregate net loss equal to 75% of net premiums written with a minimum retention of $605,000
	Coverage:	100% of aggregate net losses in excess of 75% of net premiums written.
	Reinsurance premium:	Rate of losses incurred divided by net premiums written for last eight years losses incurred times 125%, applied to net premiums written with a minimum rate of 6% and a maximum rate of 25%. Subject to minimum of $48,000.

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2002. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Watertown Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2002

Assets	**Ledger**	**Nonledger**	**Not Admitted**	**Net Admitted**
Cash in Company's Office	$ 100	$	$	$100
Cash Deposited in Checking Account	129,146			129,146
Cash Deposited at Interest	205,000			205,000
Bonds (at Amortized Cost)	475,712			475,712
Stocks or Mutual Fund Investments (at Market)	430,759			430,759
Real Estate	49,794			49,794
Premiums and Agents' Balances and Installments:				
In Course of Collection	8,036			8,036
Deferred and Not Yet Due	84,150			84,150
Investment Income Accrued		9,834		9,834
Electronic Data Processing Equipment	2,822			2,822
Furniture and Fixtures	9,217		9,217	
TOTALS	$1,394,736	$9,834	$9,217	$1,395,353

Liabilities and Surplus

Net Unpaid Losses	$80,000
Unpaid Loss Adjustment Expenses	6,921
Commissions Payable	34,944
Fire Department Dues Payable	846
Federal Income Taxes Payable	1,686
Unearned Premiums	460,000
Reinsurance Payable	50,353
Amounts Withheld for the Account of Others	1,192
Other Liabilities:	
Expense Related:	
Accounts Payable	10,000
Accrued Property Tax	2,088
Accrued Wages	2,700
TOTAL LIABILITIES	650,730
Policyholders' Surplus	744,623
TOTAL	$1,395,353

Watertown Mutual Insurance Company
Statement of Operations
For the Year 2002

Net Premiums and Assessments Earned		$650,800
Deduct:		
Net Losses Incurred	215,780	
Net Loss Adjustment Expenses Incurred	43,849	
Other Underwriting Expenses Incurred	284144	
Total Losses and Expenses Incurred		543,773
Net Underwriting Gain (Loss)		107,027
Net Investment Income:		
Net Investment Income Earned	13,504	
Net Realized Capital Gains	5,384	
Total Investment Income		18,888
Other Income:		
Miscellaneous	33,113	
Total Other Income		33,113
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes		159,028
Policyholder Refunds or Dividends		0
Net Income (Loss) Before Federal Income Taxes		159,028
Federal Income Taxes Incurred		7,310
Net Income (Loss)		$151,718

Watertown Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	1998	1999	2000	2001	2002
Surplus, beginning of year	$767,274	$716,497	$799,245	$907,925	$676,139
Net income	(108,071)	126,504	13,008	(218,975)	151,718
Net unrealized capital gains or (losses)	57,027	(21,620)	90,518	(17,878)	(86,463)
Change in non-admitted assets	267	(22,136)	5,154	5,067	3,229
Surplus, end of year	$716,497	$799,245	$907,925	$676,139	$744,623

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2002, Annual Statement			$744,623
Item	**Increase**	**Decrease**	
Reinsurance Payable	$7,365	$	
Federal Tax Payable	2,312		
Unearned Premium	8,150		
Fire Dues	123		
Unpaid Losses		8,884	
Total	$17,950	$8,884	
Increase to Surplus per Examination			9,066
Policyholders' Surplus per Examination			$753,689

Reclassification Account	**Debit**	**Credit**
Unearned Premium	$18,710	
Advanced Premium		$18,710
Total	$18,710	$18,710

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were no recommendations in the prior examination report.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with apparent conflicts disclosed below.

One director sells securities as his profession. This director also serves on the company's investment committee. According to the company manager, this person does none of the actual investing for the company and is in a strictly advisory position. All investments are bought and sold through the company's outside investment broker. One of the directors was also noted as being a director for another company or organization.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond – Forgery or Alteration, Securities, Trading Loss	$ 100,000

Agents Liability	300,000
Combined Insurance Company Liability and	
Directors and Officers Liability	1,000,000
Worker's Compensation:	
Bodily Injury by Accident (each accident)	100,000
Bodily Injury by Disease (policy limit)	500,000
Bodily Injury by Disease (per employee)	100,000
Business Owners Coverage:	
Includes:	
Property Coverage:	
Building	161,620
Contents	10,000
Business Income	Actual loss sustained
Money and Securities	
Inside Premises	10,000
Outside Premises	5,000
Accounts Receivable	10,000
Valuable Papers	10,000
Liability Coverage:	
Liability and Medical Expenses (per occurrence)	1,000,000
Medical Expenses (any one person)	5,000
Fire Legal Liability (any one fire)	100,000
Products-Completed Operations Aggregate Limit	2,000,000
General Aggregate Limit (other than products)	2,000,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing. The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and of renewal business is inspected by committee members independent of the risk under consideration and review.

Agents

The company is to submit listing information with the Office of the Commissioner of Insurance for all agents that write business for the company in accordance with s. 628.11, Wis. Stats. The examination noted that one agent listed as writing business for the company on the company's computer system was not recorded on the company's Registered Agent List provided with the Office of the Commissioner of Insurance. When this was brought to the company's attention, an application was promptly submitted prior to the end of fieldwork. It is recommended that the company timely submit applications with the Office of the Commissioner of Insurance for all the company's agent appointments in accordance with Section 628.11, Wis. Stats.

The company requires its agents to obtain adequate errors and omissions (E & O) coverage. It is the company's policy to obtain proof of the agent's E & O coverage at the time the agent is appointed as an agent of the company. It is recommended that the company obtain and retain a copy of all their agents' current E & O documentation on an annual basis to provide assurance that company agents have adequate E & O coverage.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

Accounts and Records

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2002.

It was noted during the testing of the bank reconciliation that the outstanding check listing as of December 31, 2002 did not contain the data necessary to determine if there were any escheat checks under Section 177, Wis. Stat.. Generally, an outstanding check listing includes the same information maintained on the cash disbursements journal in accordance with s. Ins 13.05, Wis. Adm. Code: date, payee, check number, and amount of check. Therefore, it is recommended that the company establish an outstanding check listing that contains all data required on the cash disbursements journal in accordance with s. Ins 13.05, Wis. Adm. Code.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. It was noted that access to the computer system is not limited to people authorized to use the system. It is recommended that the company establish procedures to limit access to its computer systems to only those individuals authorized to access the company's systems.

Company personnel back up the computers daily and the backed-up data is kept on-site in a locked fireproof filing cabinet. It is recommended that the company establish a procedure in which the backed-up data is kept at a safe location other than the location of the computer.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan. However, its disaster recovery plan does not appear to be adequate because the plan does not address an alternate worksite in case of a disaster. It is recommended that the company develop a disaster recovery plan.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

Investment Rule Compliance

Section Ins. 6.20 (6), Wis. Adm. Code allows a town mutual insurance company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$ 950,730
2.	Liabilities plus 33% of gross premiums written	978,688
3.	Liabilities plus 50% of net premiums written	1,018,580
4.	Amount required (greater of 1, 2, or 3)	1,018,580
5.	Amount of Type 1 investments as of 12/31/2002	931,989
6.	Excess or (deficiency)	$ (86,591)

The company does not have sufficient Type 1 investments.

The company was granted an exception to hold collateralized mortgage obligations (CMO's) until they mature. The last CMO will mature in 2020.

Section Ins. 6.20, Wis. Adm. Code prescribes that a town mutual shall divest any investment which does not comply with the rule within three years of its noncompliance, unless the Commissioner permits a longer period or requires a shorter period. Currently the company has four investments, with a statement value of $9,037, that are not in compliance with the investment rules. The company's plan to bring these investments into compliance was approved by the Commissioner.

ASSETS

Cash and Invested Cash **$334,246**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 100
Cash deposited in banks-checking accounts	129,146
Cash deposited in banks at interest	205,000
Total	$334,246

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in one bank. Verification of checking account balance was made by obtaining confirmations directly from the depository and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of seven deposits in seven depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2002 totaled $5,946 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 2.50% to 7.25%. Accrued interest on cash deposits totaled $2,395 at year-end.

Book Value of Bonds **$475,712**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2002. Bonds owned by the company are held under a safekeeping agreement with Waukesha State Bank.

Bonds on the company’s list were compared with bonds listed on the December 31, 2002 safekeeping statement by examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2002 on bonds amounted to $25,430 and was traced to cash receipts records. Accrued interest of $7,439 at December 31, 2002, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$430,759**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2002. Stocks owned by the company are held under a safekeeping agreement with Waukesha State Bank.

Stock certificates on the company's list were compared with bonds listed on the December 31, 2002 safekeeping statement by examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers, except as noted under the caption, "Investment Rule Compliance."

Dividends received during 2002 on stocks and mutual funds amounted to $7,697 and were traced to cash receipts records. There were no accrued dividends at December 31, 2002.

Book Value of Real Estate **$49,794**

The above amount represents the company's investment in real estate as of December 31, 2002. The company's real estate holdings consisted of home office building and land.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line method.

Agents' Balances or Uncollected Premiums **$8,036**

The above ledger asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset.

Premium and Installments Booked but Deferred and Not Yet Due **$84,150**

The above ledger asset represents premiums which are receivable from policyholders but which are not yet due as the policyholder has chosen a semiannual or quarterly billing mode. The company's computer system calculates those amounts which are deferred. A test of the accuracy of the information on the system was performed with no exceptions noted. Therefore, the balance as stated was accepted for examination purposes.

Investment Income Due and Accrued **$9,834**

Interest due and accrued on the various assets of the company at December 31, 2002, consists of the following:

Cash at Interest	$2,395
Bonds	7,439
Total	$9,834

The accrued amounts were verified by tracing the amounts to subsequent receipts.

Equipment, Furniture, and Supplies (EDP Equipment) **$2,822**

This asset consists of computer equipment, excluding software and net of accumulated depreciation, owned by the company at December 31, 2002. Examiners checked the cost basis of this equipment to company records and evaluated the company's depreciation schedule for propriety in establishing the amount of this asset. The amount reported for EDP equipment appears to be reasonable.

Equipment, Furniture, and Supplies **$0**

This non-admitted asset consists of $9,217 of furniture and fixtures owned by the company at December 31, 2002. In accordance with annual statement requirements, this amount has been deducted as a non-admitted asset.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$88,884**

This liability represents losses incurred on or prior to December 31, 2002, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule. Differences are reflected in the section of this report captioned "Reconciliation of Policyholders' Surplus."

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	$237,500	$348,777	$(111,277)
Less:			
Reinsurance Recoverable on Unpaid Losses	157,500	259,893	(102,393)
Net Unpaid Losses	$80,000	$88,884	$(8,884)

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2002. To the actual paid loss figures was added an estimated amount for those 2002 and prior losses remaining unpaid at the examination date, if any.

The examiners development of unpaid losses determined the company had deficient reserves at December 31, 2002. The deficiency is a result of under reserving for incurred but not reported losses. Therefore, it is recommended the company increase its liability for incurred but not reported reserves that reflect the development of incurred but not reported losses.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses **$6,921**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2002, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is based on the General Manager's experience with the claim adjusting companies used by the company based on type of claim.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable **$34,944**

This liability represents the commission's payable at December 31, 2002. The examiners reviewed the company's commission calculation and found the liability to be correctly calculated. The actual amounts paid were verified to cash disbursements and canceled checks.

Fire Department Dues Payable **$723**

This liability represents the fire department dues payable at December 31, 2002.

The examiners reviewed the company's fire department dues calculation and found this liability to be incorrectly calculated. This liability was overstated by $123. The actual amount paid was verified to the cash disbursement records.

Federal Income Taxes Payable **$(626)**

This liability represents the balance recoverable at year-end for federal income taxes incurred prior to December 31, 2002.

The examiners reviewed the company's 2002 tax return and verified amounts applied to 2003 estimated tax payments.

Unearned Premiums **$451,850**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

The above liability includes $18,710 of premiums received in advanced. It is recommended that the Company report premiums received in advance on the line designated for premiums received in advance in accordance with Annual Statement Instructions.

The company overstated unearned premium in the amount of $8,150 by using the previous year's number in portions of the calculation when the current year's information was available. It is recommended that the company use current data in establishing liabilities when information is available.

Reinsurance Payable **$42,988**

This liability consists of amounts due to the company's reinsurer at December 31, 2002, relating to transactions which occurred on or prior to that date and was determined as follows:

Class A	$10,750
Class C-1	2,750
Class C-2	2,075
Class D/E	3,525
First Surplus	6,012
First Surplus (Commission)	(902)
Deferred portion	7,409
Adjusted Excess & Stop Loss	18,734
Total	$50,353

The examination amount of $42,988 is $7,365 less than that reported by the company. The company used an estimated amount, $18,734, in calculating the excess and stop-loss premium amount of the payable at year end. The actual amount is $11,369, which resulted in the difference in the payable. This adjustment is reflected in the section of this report captioned "Reconciliation of Policyholder's Surplus."

Subsequent cash disbursements and reinsurance accountings were used by the examiners to determine the amount of this liability.

Amounts Withheld for the Account of Others **$1,192**

This liability represents employee payroll deductions in the possession of the company at December 31, 2002. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$10,000**

This liability represents accrued pension payable for the company's SEP plan. The amount is determined by the company's net income before taxes and pension expense. The distribution for 2002 was 14% of wages, since the company posted a net income before taxes and pension cost of $169,024. Supporting documents and subsequent cash disbursements verified this item.

Accrued Property Taxes **$2,088**

This liability represents the company's portion of property taxes incurred prior to December 31, 2002, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accrued Wages **$2,700**

This liability represents amounts payable for wages of the company's employees at December 31, 2002, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

V. CONCLUSION

The examination of Watertown Mutual Insurance Company resulted in five adjustments and one reclassification, which increased surplus $9,066 to $753,689. As a result of the work performed, there were recommendations in the accounting and electronic data processing areas.

During the period under examination the company had three years of relatively high windstorm losses resulting in composite ratios greater than 100%. The Company had two years of lower windstorm losses resulting in decreased loss ratios and the generation of income. The company's surplus, premium written and policies in-force remained stable over the period under examination.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 17 - Agents—It is recommended that the company timely submit applications with the Office of the Commissioner of Insurance for all the company's agent appointments in accordance with Section 628.11, Wis. Stats.

2. Page 18 - Agents—It is recommended that the company obtain and retain a copy of all their agents' current E & O documentation on an annual basis to provide assurance that company agents have adequate E&O coverage.

3. Page19 - Accounts and Records—It is recommended that the company establish an outstanding check listing that contains all data required on the cash disbursements journal in accordance with s. Ins. 13.05, Wis. Adm. Code.

4. Page 20 - EDP Environment—It is recommended that the company establish procedures to limit access to its computers systems to only those individuals authorized to access the company's system.

5. Page 20 - EDP Environment—It is recommended that the company establish a procedure in which the backed-up data is kept at a safe location other than the location of the computer.

6. Page 20 - Disaster Recovery Plan—It is recommended that the company develop a disaster recovery plan.

7. Page 25 - Net Unpaid Losses—It is recommended the company increase its liability for incurred but not reported reserves that reflect the development of incurred but not reported losses.

8. Page 27 - Unearned Premium—It is recommended that the Company report premiums received in advance on the line designated for premiums received in advance in accordance with Annual Statement Instructions.

9. Page 27 - Unearned Premium—It is recommended that the company use current data in establishing liabilities when information is available.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Eleanor Oppriecht of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Respectfully submitted,

Amy J. Wolff
Examiner-in-Charge